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**BEFORE THE ARIZONA CORPORATION COMMISSION**

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Arizona Corporation Commission

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JUL 15 2010

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14 APPLICATION OF ESTATE OF  
15 WILLIAM F. RANDALL DBA VALLE  
16 VERDE WATER COMPANY FOR AN  
17 INCREASE IN ITS WATER RATES

Docket No. W-01431A-09-0360  
W-01431A-09-0361

**POST-HEARING REPLY BRIEF**

18 APPLICATION OF ESTATE OF  
19 WILLIAM F. RANDALL DBA VALLE  
20 VERDE WATER COMPANY FOR  
21 AUTHORITY TO INCUR LONG-TERM  
22 DEBT

23 The Estate of William F. Randall, dba Valle Verde Water Company ("Company"  
24 or "Valle Verde") hereby files this Post-Hearing Reply Brief ("Reply"). While there may  
25 be minor differences of opinions on discrete issues, the Company is pleased to note that  
26 at this point there seems to be only two significant issues that the parties have not  
27 resolved. Those remaining issues are:  
28

- 1 • Staff's use of a formula which treats depreciation in such a way that the end result  
2 is a net income of less than \$600 at best.
- 3 • Staff's use of a formula that predicts the Company's property tax expenses will  
4 drop 35% even though its revenues are increasing substantially compared to the  
5 actual tax paid during the test year.

6 The Company reasonably believes that Staff's formulas, as applied here, will jeopardize  
7 the Company's ability to meet its long-term financial obligations and make necessary  
8 system improvements.

### 10 **1.0 AGREEMENT ON TEMPORARY SURCHARGE AND GRANT FUNDED PROJECTS**

11 1.1 Temporary Surcharge. In its response, it appears as though Staff agreed  
12 with most, if not all, of the Company's temporary surcharge plan. As stated in the  
13 Company's post-hearing brief:  
14

15 Valle Verde is seeking a temporary \$.60 per 1,000 gallons of water  
16 surcharge designed to pay the debt within 18 months (reference omitted).  
17 The funds would be tracked as a revenue stream dedicated solely to repay  
18 the debt to Nogales. The Company would discontinue the surcharge as  
soon as the debt is paid.

19 Post-Hearing Brief at p. 6. The only point that needs clarification is that Staff seems to  
20 indicate that the Company's proposal set a date certain deadline. Admittedly, the  
21 Company's reading may not be accurate. But in any case, to clarify this point, the  
22 Company notes that its plan as proposed does not include a date certain at which time the  
23 surcharge would no longer be effective – the surcharge would end when the debt is paid.  
24

25 1.2 Grant Funding. Staff and the Company agree that whether or not the grant  
26 funds are treated as CIAC is irrelevant because the rate base is negative. See Staff's  
27 Response at p. 5, ln. 16-20. Thus, there is no issue that needs to be addressed further.  
28

1 **2.0 DEPRECIATION IS AN OPERATING EXPENSE AND SHOULD NOT BE USED TO**  
2 **SERVICE DEBT.**

3 At the hearing, Staff's witness and Public Utilities Analyst Pedro Chaves testified  
4 that Staff's then-proposed rates would generate less than \$600 of net income:

- 5 • (Wene Question) Do you agree that the net income is going to be \$600?
- 6 • (Chaves Answer) Less than \$600, yes.
- 7 • (Wene Question) Less than \$600?
- 8 • (Chaves Answer) A little bit less than \$600.
- 9
- 10

11 Hearing Transcript at p. 170, ln. 25 – p. 171, ln. 8. In other words, so long as there are no  
12 significant plant failures or unforeseen expenses, the Company would net a little less than  
13 \$50 per month. (Actually, Staff's Final Schedules calculate an annual net income is an  
14 \$8 loss).

15  
16 But nobody can reasonably believe that the distressed, 730-connection Valle  
17 Verde water system will not have significant plant failures over the next few years.  
18 So when a pump suddenly fails and needs to be replaced, for example, the question  
19 facing the Company's interim manager will be "who is not going to get paid: Company  
20 staff, the pump vendor, the contractor who serviced the pump, the electric utility, WIFA,  
21 or the Santa Cruz County tax collector?" Even if nothing went wrong with the system  
22 but the Company loses 10 paying customers, or customers begin to conserve water as  
23 intended by the tiered rates, the Company will be left with a significant financial  
24 shortfall. The bottom line is that Staff's proposal would set rates virtually ensuring the  
25 Company will not be able to meet its financial obligations.  
26  
27  
28

1 Over the past few months, issue of whether Staff's proposal will generate enough  
2 revenue to enable the Company to meet its financial obligations has been commonly  
3 referred to as the "depreciation issue" because the Company asserts that the problem  
4 arises due to the fact that Staff is "backing out" depreciation from operating income and  
5 including it as cash flow to be used to service the proposed WIFA debt. This proposal,  
6 neither standard nor obvious adjustment to the typical rate-making formula, leaves the  
7 Company with virtually no net income. More importantly, while depreciation is by  
8 definition the rightful pro rata recovery of the cost of an asset to recover money already  
9 spent, in this case, it is a cash source needed to make major plant repairs. Tr. at p. 106,  
10 ln. 11 - p. 108, ln. 4 (Rowell).  
11  
12

13  
14 In its Response, Staff continued to assert support for its formula and made a few  
15 other points that warrant brief responses. First, Staff states that it is the Company's claim  
16 or assertion that it will only have \$600 of net income using Staff's depreciation  
17 methodology. As pointed out above, the fact that Staff's proposed rates would generate a  
18 net income of less than \$600 is the sworn testimony of Staff witness Chaves. Tr. at p.  
19 170, ln. 25 – p. 171, ln. 8. It is not simply a Company claim; it a fact offered by Staff.  
20  
21

22 Second, Staff asserts that the Company does not understand Staff's methodology.  
23 To the contrary, the Company understands what Staff refers to as a "cash flow analysis"  
24 very well. In fact, the Company was able to identify that the formula would result in a  
25 net income of less than \$600, even though this calculation is not readily apparent in  
26 Staff's schedules.  
27  
28

1 Third, Staff seems to take issue with the fact that this issue was not expressly  
2 addressed in the Company's initial round of testimony filings. However, this issue did  
3 not fully develop as a driving factor of rates until the Staff made it clear that it was  
4 reducing the Company's proposed operating expenses by approximately \$250,000 and  
5 that its analysis and depreciation treatment was purposely applying depreciation to cover  
6 debt expense. The purpose of cross-examination and rejoinder testimony is to give  
7 parties like the Company an opportunity to learn about and respond to Staff's reply,  
8 which it did. Finally, it goes without saying that during the testimony filing process and  
9 during cross-examination at hearings, it is common for "new" issues to arise. For  
10 example, during the hearing, based upon information gathered during cross-examination  
11 of a Company witness, Staff made an issue of the grant funding and requested additional  
12 testimony and documentation regarding that topic even after the hearing was concluded.  
13 The Company is not complaining because such issue development is relevant and proper.  
14 This is why the Company does not understand why Staff continues to complain,  
15 especially where the Company's responsive testimony was prefiled prior to the hearing in  
16 accordance with the court's procedural order. The Company acted in good faith and  
17 identified the issue in a timely fashion.

23 **3.0 ACTUAL TEST YEAR PROPERTY TAX EXPENSE SHOULD BE USED TO**  
24 **DETERMINE THE COMPANY'S REVENUE REQUIREMENT.**

25 Deciding this issue will turn upon how the evidence is weighed. The Company  
26 presented real data regarding the actual test year tax expense – \$14,129.14. Meanwhile,  
27 Staff presented an estimate based upon a "modification" of the Arizona Department of  
28

1 Revenue method ... which is typically employed by Staff" that estimates the Company's  
2 taxes will be \$5,021 less than the tax expense paid during the test year. See Staff's  
3 Responsive Brief and Notice of Filing Final Schedules at p. 4, ln. 10-12 (emphasis  
4 added). The Company continues to maintain that the actual test year tax expense data  
5 should be given the most weight, especially here where Staff's recommendation results in  
6 a 35% property tax expense decrease, while gross revenues will increase by \$285,075,  
7 from \$276,656 to \$561,730, or 103.04%.

10 Without any other reasonable explanation as to why the Company's tax burden  
11 will drop so dramatically, Staff suggests that Santa Cruz County is overtaxing the  
12 Company. See Response at p. 4, ln. 18-21. But there is no evidence to support this  
13 claim. Thus, the Court should find that the actual test year tax expense is the more  
14 compelling evidence.

17 RESPECTFULLY SUBMITTED this 15<sup>th</sup> day of July, 2010.

18 **Moyes Sellers & Sims Ltd.**

19 

20 Steve Wene  
21 Attorneys for Valle Verde Water Company

22  
23 Original and 15 copies of the foregoing  
24 filed this 15<sup>th</sup> day of July, 2010, with:

25 Docket Control  
26 Arizona Corporation Commission  
27 1200 West Washington  
28 Phoenix, Arizona 85007

1 Copy of the foregoing mailed this  
2 15<sup>th</sup> day of July, 2010, to:

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